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SUBJECT: CORRECTED COPY: CHINA SETS SIGHTS HIGH FOR NEW REGIONAL JET

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¶1. (SBU) Summary: China's ambition to produce a domestically designed and manufactured aircraft, the ARJ21 "regional jet", is nearing reality. During a January 8 visit to the Commercial Aircraft Corporation of China (COMAC), Consulate officers talked with company executives and viewed the plane that passed its initial test flight in November. U.S. suppliers provide seventy percent by value of the ARJ21's parts, giving U.S. companies a significant stake in its success. COMAC hopes to obtain necessary certifications within two years and deliver the first planes to customers before the end of 2010. However, U.S. Federal Aviation Administration (FAA) involvement in the validation of the ARJ21 has stalled, clouding the prospects of obtaining U.S. certification. Besides the ARJ21, COMAC also plans to develop a large commercial aircraft. Outside observers, however, question the commercial potential of the ARJ21 and the large commercial jet. Because the success of the aircraft is a matter of patriotic pride, the Central Government and Shanghai Government are going to great lengths to promote the project. End Summary.

Background on COMAC the ARJ21 and Plans for a New Jumbo Jet

¶2. (SBU) The regional jet will be China's first domestically designed and manufactured commercial aircraft. The ARJ21 was designed with a flight range of 3,700 km, which enables airlines to provide point-to-point services to over 80 percent of the existing domestic air routes in China. The ARJ21 has a maximum of 90 seats for single class seating and 78 seats for mixed class seating.

¶3. (SBU) The project was initiated in February 2002 under guidance from the Central Government. In 2003, the Avic I Commercial Aircraft Company (ACAC), formerly known as Avic I, applied to the General Administration of Civil Aviation of China to begin the certification of the ARJ21. In the same year, ACAC began developing and manufacturing the plane in Shanghai. In May 2008, COMAC was set up to oversee the development of the ARJ21. (Note: Although COMAC oversees the project, ACAC still serves as the responsible legal and operational entity of the ARJ21.) COMAC International Cooperation and Supplier Management

General Manager Tao Zhihui said the total registered capital of COMAC is USD 2.8 billion, and it has the following shareholders: the State-owned Assets Supervision and Administration Commission of the State Council (31.5 percent), Guosheng Group (26.3 percent), ACAC (26 percent), and China Aluminum Corp, Baosteel and Sinochem (5.26 percent each). (Note: Guosheng Group is an investment arm of the Shanghai Municipal Government. End note.)

Initial Test Flight Completed with More to Come

¶4. (SBU) During a January 8 visit to COMAC, the Consul General and Econoffs talked with company executives and viewed an ARJ21 that passed its initial test flight on November 28, 2008. The hour-long test flight was revealed by state media only after the plane had landed. COMAC plans to conduct a second test flight of the same aircraft in early February, after which the aircraft will be relocated to Xian for further certification testing. A test flight for a second prototype aircraft is scheduled to take place in April, followed by a third aircraft in June, according to Tao. The prototypes were also on display during our visit to COMAC.

U.S. - Big Supplier of Components

¶5. (SBU) According to COMAC President Jin Zhuanglong, U.S parts make up roughly seventy percent by value of the total ARJ21 components. Some of the larger components include General Electric CF34-10A engines, a Parker Aerospace fuel system, a Hamilton Sunstrand APS 2300 auxiliary power unit, a Honeywell flight control system and a Rockwell Collins FMS 4200 flight management system. Jin said for the upcoming jumbo jet project - and in contradiction of Shanghai press reports that appeared shortly after our January 8 factory visit - COMAC would also

prefer parts from U.S suppliers.

FAA Certification of ARJ21 up in the Air

¶6. (SBU) According to FAA officials based in China, the FAA program to evaluate the certification capability of the CAAC, and to simultaneously validate the aircraft to U.S. certification standards, has stalled. The FAA established an office in Shanghai in the summer of 2006 to mentor the CAAC during the initial stages of their certification process and enable CAAC to successfully undergo a "shadow certification" program. (Note: The term "shadow certification" is used because transport category airplanes such as the ARJ21 are not part of the bilateral agreement with China.) However, the FAA shadow certification has not yet begun due to a disagreement with CAAC over the methods in which they validate already-FAA-certified airplane components, such as aircraft engines, imported into China. CAAC is requiring more design details of the components than is required under the existing bilateral agreement. The delay in the start of the shadow certification has not yet reached the critical stage as the ARJ21 is already behind schedule. However, further delays could jeopardize the FAA shadow certification altogether as it would be too late for FAA to witness certain critical certification events. FAA continues to discuss this topic with the CAAC with a hope to resolve the issue in the near term. (Comment: CAAC's demand for detailed information on U.S. airplane specs coincides with the Shanghai Government's announcement of a new company to produce an engine for the nation's large commercial airline. FAA and U.S. engine aircraft producers worry the CAAC is requesting the additional information so it can simply be handed over to AVIC Commercial Aircraft Engine Co. Ltd, which will produce engine parts for the nation's large commercial jet. End comment.)

Orders Lined Up for 2010 Delivery

¶7. (SBU) COMAC hopes to deliver the first ARJ21 planes to customers before the end of 2010. It currently has orders for 206 aircraft. Some of the buyers include Shanghai Electric Leasing (30 aircraft), Shenzhen Financial Leasing (20), Shandong Airlines (10) and Shanghai Airlines (5). Another purchaser will be Kunpeng Airlines, in which the U.S. airline Mesa is a partner. Some of the orders are based on written contracts while others are based on oral agreements, according to Tao. (Note: In a separate January 2009 conversation, a high level Shanghai Reform and Development Commission official revealed that the Central Government had mandated that certain state-owned airlines purchase a certain quota of the ARJ21. End note.) Jin said the 2010 delivery is presently on a tight schedule and could be delayed.

Hopes for Larger Market, But Will Not Compete with Boeing

¶8. (SBU) Although there are not yet any orders from outside China, ACAC and the Central Government hope that it will gain a foothold in other emerging markets. Jin also noted that the ARJ21 will not compete directly with Boeing and Airbus because it is targeting a niche market of shorter, regional routes.

Economic Downturn Not Hurting Orders

¶9. (SBU) Jin said that the global economic downturn has had little impact on ARJ21 orders since most of the orders are from domestic airlines. (Note: Because of the economic downturn, CAAC has urged state-run carriers to cancel or delay aircraft deliveries. The policy does not apply to the ARJ21 since it is a domestic aircraft.) According to Jin, China's stimulus package, which calls for the establishment or expansion of regional airports, will actually boost demand for the ARJ21 in the long run. COMAC plans to expand its aircraft production capacity within five years and hopes the Chinese economy will have recovered by then.

Plans for a Large Commercial Jet

¶10. (SBU) The ARJ21 is only part of China's plan to compete in the airline market - it also plans on manufacturing a "trunkliner" large commercial jet, which will directly compete with certain Boeing and Airbus models. COMAC will oversee the development of the new large commercial jet. On January 18, the Shanghai Government announced the inauguration of a new company, AVIC Commercial Aircraft Engine Co. Ltd, which will produce engine parts for the nation's large commercial jet. The Aviation Industry Corporation of China (COMAC's parent company) is 40 percent owner, with Guosheng Group and Shanghai Electric Group each owning 15 percent stakes. The R&D center and the assembly center for the engines will both be located in Shanghai.

¶11. (SBU) According to media reports, Shanghai Party Secretary Yu Zhengsheng and Mayor Han Zheng both attended the January 18 ceremony and praised the establishment of the newly formed company as helping Shanghai achieve its ambition to become China's "aviation base." Local press reports highlighted that all facets of the large commercial jet project - from material sourcing and production ultimately will be done in China as the country aims to reduce its reliance on overseas suppliers. Jin said that, in contradiction of Shanghai press reports however, COMAC would prefer parts from U.S suppliers for the large commercial jet.

COMAC Attracting Top Engineering Talent

¶12. (SBU) Tao said COMAC has little problem attracting and retaining China's top engineering talent because of its location in Shanghai and competitive salary. According to Tao, the

starting salary for COMAC's engineers is about USD 650 per month, and there are ample opportunities for promotion and salary increases. Most of COMAC's engineers are recruited from Xian, Beijing and Shanghai because these cities are home to China's aviation universities.

Comment

¶13. (SBU) China's quest to manufacture commercial aircraft is tightly wrapped up with national pride. Local and national media outlets regularly report on developments related to the ARJ21 and longer-term jumbo jet plans. For example, on January 9, 2009, Xinwen Lianbo ran a short piece showing the ARJ21 factory floor with the three test planes to simply show China's accomplishments. Following the November 2008 inaugural ARJ21 test flight, the state media hailed the flight as "China's entry into the ranks of the world's passenger aircraft makers."

¶14. (SBU) However, little heed is given to whether the aircraft can effectively compete on the open market without government assistance. In a January 2009 conversation with Congenoff, a senior Shanghai Airlines procurement official said that diversifying airline fleets with this new type of aircraft will be an expensive proposition because of the costs of stocking different repair parts and training technicians. He added that many Chinese airline officials were initially opposed to the idea but were strong-armed into placing orders for the ARJ21 by the Central and Shanghai Governments. Also in January, a senior official from Juneyao Airlines, Chinese largest private airline, seconded the opinion about the costliness of diversifying airline fleets to include the ARJ21 and said that concern is the main reason the company has refrained from placing orders for the ARJ21. The CEO of Delta told the CG that this size plane is "redundant" because other commercial aircraft are already available to fill the seating and range parameters for which the ARJ21 has been designed, evincing pessimism about the ARJ21's sales prospects and profitability.

¶15. (SBU) Chinese officials have also used the aviation projects to tout China's indigenous innovation. In his January 13 Work Report to the annual plenary meeting of the Shanghai Municipal People's Congress, Shanghai Mayor Han Zheng stated that the "the large commercial aircraft project will be expedited" as part of "boosting homegrown innovation." Much ado has also been made about the ARJ21 as a model for China's development of its own intellectual property. However, our Shanghai Airlines procurement interlocutor noted that much of

the innovation originated from Boeing, Airbus and their established suppliers. He explained that as those two companies source more and more of their parts from China, however, ACAC will be able to acquire more knowledge of how to put planes together.
CAMP